

**Prepaid and Emerging  
Payments Year in Review  
*2011: Exciting, Tumultuous  
Change and Growth***

**Bryan Cave Payments Group  
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**2011**



# Bryan Cave's Prepaid and Emerging Payments Team

For legal counsel and advice in:

Prepaid and Stored Value | Mobile and Contactless Payments | Bank Regulatory Compliance | Money Services Business (MSB) Compliance  
Electronic Wallets and P2P Payments | Anti-Money Laundering Compliance | Bill Payment, Overdrafts and Lines of Credit | Retail Gift Cards | Abandoned Property  
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*A Broader Perspective<sup>SM</sup>*

# Agenda

## Federal legal developments:

- Dodd Frank Act – **Judie Rinearson**
  - The Consumer Financial Protection Bureau (CFPB)
  - The Durbin Amendment and FAQs
  - Remittances
- Anti-Money Laundering Laws - **Kris Andreassen & Margo Strahlberg**
  - FinCEN's Prepaid Access Rules (and FAQs)
  - Proposed Cross-Border Legislation & Regulation
- Banking Regulatory developments – **John ReVeal**
  - Preemption
  - Merger of Federal Bank Regulators
  - Federal Payments onto prepaid cards
  - Third Party Relationships
- Consumer Protection since the CARD Act – **Carol Osborne**
  - Menendez and Blumenthal legislation
  - CFPB – Initial regulatory steps

# Agenda

## State Legal Developments

- Consumer Protection Laws – **Carol Osborne**
- Abandoned Property Developments – **Margo Strahlberg**
  - **New Jersey Litigation & Impact on Prepaid Card Programs**
- State money transmitter licensing laws – **Jennifer Crowder**
- Structural Issues for new Payments Businesses – **Katherine Koops**
- Privacy and Data Protection – **David Zetoony**

## Product Developments:

- Mobile pay and electronic wallets – **Jennifer Crowder**
- Payroll cards, Remote Deposit Capture, Lending products – **Barry Hester**
- “Social couponing” – (Groupon, Gilt, etc) – **Carol Osborne**
- Smart Cards/Chip cards – NFC and EMV – **Judith Rinearson**

## Pre-Submitted Q & As

# Judie Rinearson

Dodd-Frank Act  
CFPB  
Durbin Amendment

# Dodd Frank Wall St Reform and Consumer Protection Act (“Dodd-Frank”) passed May 2010

- Huge law – sweeping changes to financial services and banking in the US
- Seeking to avoid another “meltdown” and “too big to fail” entities
  - Hedge Funds; Wall Street Transparency; non-bank financial services; insurance; swaps; asset-backed securities; investor protections;
- Areas with Major impact on prepaid and emerging payments:
  - Consumer Financial Protection Bureau
  - Durbin Amendment – Interchange and Routing
  - Remittances

# Dodd-Frank and the CFPB

- The Consumer Financial Protection Bureau (“CFPB”) is a new Consumer Protection Agency for financial services.
- For the first time, there will be a federal regulator over both banks AND certain non-bank financial institutions, such as payday lenders, check-cashers and mortgage brokers.
- The scope of CFPB powers is broad and includes selling, providing or issuing “stored value.”
- Conventional Wisdom: CFPB would have power to regulate non-banks ONLY after a “confirmed Director” is in place.
- Recess Appointment of Richard Cordray has raised questions: Was Congress in recess? Was Cordray “confirmed” by the Senate? Does it make a difference?

# How will the CFPB work?

- Empowered to prohibit a *covered person or service provider* from committing or engaging in an unfair, deceptive or **abusive** act or practice.
- Collects data (such as complaints) or does research.
- Seeks input from industry, consumer groups, consumers.
- Will issue regulations, examine certain industry members, and bring enforcement actions (with advance notice).
- Mission: To make markets for consumer financial services “work for America.” See [www.cfpb.gov](http://www.cfpb.gov)

# How will the CFPB work?

Lessons from the payday lending industry:

- “Field Hearings” in Birmingham, AL (with little advance notice) – inviting comments from public, industry and community leaders
- More Field Hearings expected – perhaps on a monthly basis
- Requests for data from industry
- Expecting proposed regulations and active investigations

"We will begin dealing face-to-face with payday lenders, mortgage servicers, mortgage originators, private student lenders, and other firms that often compete with banks but have largely escaped any meaningful federal oversight," Cordray said

# The CFPB & Prepaid Cards

## What we're hearing from the CFPB re Prepaid

- Consumer Groups sent letter demanding extension of Reg E to all cards with a “pooled account”.
- Concerns about GPR cards and “hidden fees”
- CFPB cannot begin regulation until regulations are issued on “larger” issuers – waiting to hear determination following comments
- “Menendez” legislation as a potential starting point

## Emerging Payments?

# The Durbin Amendment

- Interchange Restrictions and Routing Restrictions: The “Durbin Amendment” – favored by Merchants
  - Impacts certain debit and prepaid cards – *not credit cards*
  - Restricts interchange to **21 cents plus a multiplier**:
    - \$50 = 24.5¢ [21¢ + 2.5¢ (\$50 x .05 /100) + 1 ¢ fraud adjustment]
    - \$500 = 47¢ [21 ¢ + 25¢ (\$500 x.05 /100) + 1 ¢ fraud adjustment] ]
  - Also for routing transactions, requires at least 2 unaffiliated networks on each card

# Durbin Amendment: 3 Exemptions

- (1) Exempt if the issuer together with its affiliates have **assets of less than \$10 billion --- OR**
- (2) Exempt if it is a debit or prepaid card provided to a person pursuant to a **federal, state or local government administered payment program** where the holder can *ONLY access funds from such program.* *But Exclusion can be lost if “provisos” not met:*
  - one year after the effective date a fee for an overdraft (including a fee assessed for a shortage of funds or for a transaction processed for an amount exceeding the account balance) **may be** charged; or a fee imposed by the issuer for the first ATM withdrawal per month from an ATM that is part of the issuer’s designated ATM network **may be** charged.
- (3) AND a **“general purpose reloadable card”** exemption....

# Durbin Amendment: The reloadable general use prepaid card exemption

Exempt if it is a “reloadable general use prepaid card” that is

- (i) **Not issued or approved for use to access or debit any account held by or for the benefit of the cardholder** (other than a **subaccount** or other method of recording or tracking funds purchased or loaded on the card on a prepaid basis)
- (ii) Reloadable and not marketed or labeled as a gift card or gift certificate; and
- (iii) ***The card is the only means of access to the underlying funds, except when all remaining funds are provided to the cardholder in a single transaction.*** Restricts convenience checks, bill pay or remittance via ACH, “because certain reloadable prepaid cards are virtually identical in function to debit cards”

*Same additional “provisos” apply as with government administered cards: no overdraft fees; 1 free ATM transaction each month.*

# Durbin Amendment **Update**: The reloadable general use prepaid card exemption

- September 9: Fed issued “Frequently Asked Questions about General-Use Prepaid Cards and Circumvention and Evasion” (FAQs).
  - Some helpful insights – such as “convenience checks payable to the cardholder” do not violate “sole means of access” obligation.
  - **But “sole means of access” still stands - bill-pay and FSA restrictions still a concern.**
- Still talk of Congressional or even legislative action regarding the new “sole means of access” requirement.
- Was effective October 1<sup>st</sup>
- Banks must self-certify to Visa and MasterCard regarding eligibility for the exemption.

# Post Durbin fall-out

- **Prices NOT lower.** Electronic Payment Coalition Survey shows “no consumer benefit” from lowered “swipe fees”. <http://bit.ly/wAeQb8> -
- However, merchants learn that cost of accepting debit and prepaid has **INCREASED** for **small dollar transactions**. <http://aol.it/tGbOv8>
  - WSJ: Visa & MasterCard have eliminated discounts on small transactions
  - Coffee shops estimate a 35% increase in interchange on transactions less than \$10
  - Consumers now asked to pay with cash.
- **“Sole means of access” limitation – criticized by Barney Frank and Spencer Bachus**

# Routing and Exclusivity

Primary change: Two Unaffiliated networks per prepaid access device with 4-party systems

Also: Prohibited exclusivity arrangements by networks.

- A **payment card network** “may not restrict or otherwise limit an issuer’s ability to contract with any other payment card network that may process an electronic debit transaction involving the issuer’s debit cards.”

Voluntary exclusive arrangements - -

- **Prohibited** even if there is no contractual rule or restriction.

Non-reloadable Open Loop Gift Cards

- Difficulty: Only one signature network per card
  - No PIN network, no addresses for sending PINs
  - Board urged to exempt such cards entirely
- Decision: **No exemption**. Instead, more time to figure it out
  - April 1, 2013

# Routing and Exclusivity

- Applies to **ALL debit and general-use prepaid cards** (Interchange exemptions don't apply here)
- Other “**form factors**”? Mobile phones? Fobs?
  - Routing restrictions still apply
  - Supplemental access device connected with a card - must also comply.
- **Not Covered:**
  - Three-party systems, ATMs

# Routing and Exclusivity

- **Displaying payment network logos** - -
  - Contractual requirements or rules that only that network's brand, mark, or logo may be displayed on a particular debit card or that otherwise limit the ability of other brands, marks, or logos to appear are *Prohibited*
  - But a debit card is *not required to* display the brand, mark, or logo of each payment card network over which an electronic debit transaction may be processed
- **Incentives permitted** –
  - Merchants cannot be prohibited or discouraged from using a particular network or authorization process
  - But payment networks CAN offer payments or incentives to Merchants to encourage specific routing.

# Effective Dates

- Interchange requirements – **October 1, 2011**
- Exclusivity for Payment Networks - **October 1, 2011**
- Routing and Exclusivity generally for issuers - **April 1, 2012**
- Routing and Exclusivity for HSA / FSA / HRA cards (those using transaction substantiation systems) – **April 1, 2013**
- Prepaid Card issuers – generally **April 1, 2013**
  - Non-reloadable sold before April 1, 2013 exempt
  - For reloadable cards sold and reloaded prior to April 1, 2013, the effective date for routing rules is May 1, 2013;
  - For reloadable cards sold prior to April 1, 2013 and reloaded on or April 1, 2013, the effective date for routing rules is 30 days after the date of reloading

# Remittances

**Dodd-Frank and CFPB will also impact international remittance services.**

## **2) Dodd-Frank Act Section 1073 – Scope**

- "Remittance transfer" is an "electronic ... transfer of funds requested by a sender located in any State to a **designated recipient [in a foreign country]** that is **initiated by a remittance transfer provider ...**"

**EXCLUSION: Small-value transactions, less than \$15.**

- "Remittance transfer provider" is "**any person that provides remittance transfers for a consumer** in the normal course of its business, regardless of whether the consumer holds an account with such person."
- A "sender" is a consumer in the US who requests a remittance transfer primarily for personal, family or household purposes.

***Remittance laws impact on both prepaid and emerging payment products.***

# Remittances

## New Regulations: Final Rule Issued January 20, 2012

Clear and conspicuous disclosures required, in writing and in a form the sender may keep:

- In advance of the transaction: disclosures must include the amount the recipient will receive, amount of the transfer and fees, and the exchange rate used.
- At the time the sender pays, sender must receive:
  - A receipt showing those transaction amounts; the promised delivery date; name of recipient; and address or phone number of the recipient (if provided by the sender).
  - A statement containing information on error resolution and cancellation rights.
  - Contact information for the remittance transfer provider, its state agency that licenses/charters the provider and the CFPB.

# Remittances

- Error resolution requirements:
  - Sender has **180 days** from the delivery date to report an error.
  - Remittance transfer provider has **90 days** to resolve the error.
- Cancellation and refund rights.
  - Sender has 30 minutes from payment to cancel the transfer.
- Liability of remittance transfer provider for its agents.
- Final Rule released Jan. 20, 2012; effective 1 year.
- Concurrent proposal rule released; requesting comments on:
  - A possible exemption for companies that do not provide remittance transfers in the normal course of business.
  - Several aspects of the Rule related to transfers scheduled many days in advance.

# Kris Andreassen

## AML: FinCEN's Prepaid Access Rule and FAQs

# FinCEN's Anti-Money Laundering Prepaid Access Regulations

- On July 26, 2011, the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued [Final Regulations on Prepaid Access](#).
- Replaces “stored value” with “prepaid access” and defines a number of new terms including:
  - Prepaid access (access to funds paid in advance, and retrievable through an electronic device or vehicle).
  - Prepaid program.
  - Provider of prepaid access.
  - Seller of prepaid access.
  - Closed loop prepaid access.
- Providers and Sellers must obtain identifying information about customers and verify their identities; file suspicious activity reports; implement effective AML compliance programs; and more.

# FinCEN Regulations: Exempt Programs

**FIRST**, a program is **NOT** a covered “prepaid program” if it meets one of these 3 **GENERAL** exemptions:

- Provides **closed loop prepaid access** to funds of up to \$2,000 maximum value in any day; OR
- Provides prepaid access solely to funds provided by a federal, state, local or other government agency; OR
- Provides prepaid access solely to funds from pre-tax flexible spending arrangements for health and dependent care expenses, or from Health Reimbursement Arrangements.

**NOTE:** **Closed loop prepaid access** is “[p]repaid access to funds or the value of funds that can be used only for goods or services in transactions involving a defined merchant or location (or set of locations), such as a specific retailer or retail chain, a college campus, or a subway system.”

# FinCEN Regulations: Exempt Programs

**SECOND**, a program is **NOT** a covered “**prepaid program**” if it meets one of these 2 **LIMITED** exemptions:

- Provides prepaid access solely to employment benefits, incentives, wages or salaries; OR
- Provides “open loop” prepaid access solely to funds not to exceed \$1,000 maximum value, and from which no more than \$1,000 can be initially or subsequently loaded, used, or withdrawn on any day.

**PROVIDED** that it *does not permit*:

- Funds or value to be transmitted internationally.
- Transfers between or among users within the program.
- Reloads from non-depository sources.

# FinCEN Regulations: Providers and Sellers

- A Provider is the participant within a *prepaid program* that agrees to serve as the principle conduit for access to information from its fellow program participants. The participants in each prepaid access program must determine a single participant to serve as the provider of prepaid access.
- A Seller is any person that receives funds or the value of funds in exchange for an initial or subsequent loading of prepaid access, if that person:
  - Sells prepaid access *offered under a prepaid program* that can be used before verification of customer identification; OR
  - Sells *any* prepaid access in excess of \$10,000 to any person during any one day, *and has not implemented policies and procedures reasonably adapted to prevent such a sale.*

# FinCEN Regulations: Obligations of Providers and Sellers

- Providers and Sellers are Money Services Businesses (MSBs). They must establish procedures to:
  - Obtain identifying information about a person who obtains prepaid access *under a prepaid program*, and
  - Verify the identity of that person.
- Identifying information includes: name, address, date of birth, and identification number.
- Sellers must *also* establish procedures to obtain identifying information about a person who obtains *any kind(s) of* prepaid access to funds that exceeds \$10,000 during any one day, and verify that person's identity.

# FinCEN Regulations: Obligations of Providers and Sellers

- Each Provider and Seller must also:
  - Develop, implement and maintain an AML compliance program.
  - File reports of suspicious activity.
  - Comply with reporting, recordkeeping and other rules applicable to MSBs generally.
- In addition, Providers must also:
  - Register as an MSB with FinCEN.
  - Maintain access to transactional records.

# FinCEN Regulations: Recent Developments

## Bank Centered Programs:

- FinCEN FAQs have confirmed that “bank-centered programs,” controlled by a bank issuer, are outside the scope of these regulations. *Regulations for banks and MSBs are “mutually exclusive.”*
- Difficult position for banks:
  - Bank regulators want banks to be “in control.”
  - Law enforcement wants program managers to register as Providers.
  - If a bank’s program manager registers: is that an acknowledgment that the bank is NOT in control?
- Latest input from one bank examiner (speaking unofficially): would prefer registration for program managers so that both are regulated.

# FinCEN Regulations: Recent Developments

## **B2B Bulk Sales:**

- FinCEN FAQs have confirmed that retailers and other companies who offer bulk sales of gift cards to incentive companies, employers or other businesses for further distribution or sale to end users/consumers by those businesses are NOT Sellers, even if such sales exceed \$10,000 to a business in a day.

## **Closed Loop Exemption:**

- However, the \$2,000 limit on exempt closed loop cards applies to the sum of all loads, usage and reloads on the card in a single day – it's not just a "cap."

## **Compliance Dates:**

- FinCEN announced a delayed compliance date for Sellers of March 31, 2012. The compliance date for most Provider obligations was similarly extended.
- FinCEN will not initiate any compliance matter or enforcement action prior to March 31 for violations of these rules, nor will it assess any civil money penalties for violations of the rules that occur prior to March 31.

## **More FAQs:**

- FinCEN is reportedly working on another set of prepaid access FAQs.

# Margo Strahlberg

## AML: Proposed Cross-Border Legislation & Regulation

# Combating Money Laundering, Terrorist Financing, and Counterfeiting Act of 2011

US S 1731, introduced by Sen. Grassley, expands reach of federal criminal money laundering statutes and redefines key BSA terms

- Adds prepaid access devices to the BSA definition of “monetary instrument,” which would then require cross-border reporting for prepaid cards.
- Also (i) explicitly expands definition of “money transmitting business” to include any business that sells or redeems prepaid access devices and (ii) explicitly amends the BSA definition of “financial institution” to include issuers, redeemers and cashiers of prepaid access devices and digital currencies.

# FinCEN Cross-Border NPRM

## Expands scope of cross-border reporting requirements

- Adds “tangible prepaid access device” to the list of other monetary instruments that must be reported at the U.S. border >\$10,000.
- “*Tangible prepaid access device*” is defined as “any physical item that can be transported, mailed, or shipped into or out of the United States and the use of which is *dedicated to obtaining access to prepaid funds or the value of funds by the possessor in any manner without regard to whom the prepaid access is issued.*”
  - Includes (i) general use prepaid cards, (ii) payroll cards, (iii) government benefits cards, and (iv) store gift cards, etc.
  - Excludes (i) credit cards and debit cards, (ii) codes and PINs, and items like computers or Web-enabled cell phones, or (iii) other devices that are not dedicated to accessing specific prepaid funds.
  - Also excludes cross-border transportation of prepaid cards by businesses shipping inventory to sales agents

# Cross-Border Obstacles/Issues

- Questionable Enforcement
  - Network branded open loop devices “can be indistinguishable from credit and debit cards.”
  - Unintentionally inaccurate (loads by third parties).
  - How to read available balance?
  - What about cards that require PINs?
- Other Considerations
  - Right to Financial Privacy.
  - State Privacy Laws.
- Bottom Line
  - Ignores existing regulatory framework and safeguards implemented by card issuers.
  - *Is this really effective in stopping cross-border money laundering?*

# John ReVeal

## Bank Regulatory Developments

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# Federal Preemption

- Preemption restricted from “occupying the field” to the “Barnett” standard:
  - A state “consumer financial law” is preempted if either:
    - the law would have a discriminatory effect on national banks as compared to state banks OR
    - under the Barnett standard, the State consumer financial law must prevent or substantially interfere with the exercise by the national bank of its powers.

# Federal Preemption

- Dodd-Frank limits preemption of state “consumer financial laws” to:
  - State consumer financial laws which discriminate against national banks
  - State consumer financial laws which are preempted by laws other than under Title 12
  - State consumer financial laws that meet the standards for preemption in *Barnett*
  - No “blanket” preemption by OCC
  - process is unclear

# Federal Preemption

- In May 2011, the OCC issued a final rule implementing Dodd-Frank
  - Eliminate preemption of state law for operating subsidiaries, agents and affiliates of national banks and federal savings associations.
  - Remove language permitting field preemption (that is, preemption over an entire body of law, even if there is no conflict, because federal law “occupies the field”).
  - Implement statutory changes made by Dodd-Frank regarding when state consumer financial laws may be preempted, based in part on the *Barnett* standard for conflict preemption.
  - Revise the OCC’s visitorial powers rule to conform to the Supreme Court’s *Cuomo* decision, recognizing the ability of state attorneys general to bring enforcement actions in court to enforce applicable laws against national banks
- OCC letter to Sen. Tom Carper (D-Dela.) states that federal preemption of state consumer protection laws would continue even under Dodd-Frank, in accordance with the *Barnett* standard.

# Federal Preemption

- *Cline v. Bank of America NA*. In October, the U.S. District Court for the Southern District of West Virginia held that the National Bank Act does not preempt claims against a bank under a West Virginia consumer protection statute.
- *U.S. Bank National Association v. Schipper*. In August, the U.S. District Court for the Southern District of Iowa ruled in favor of federal preemption, holding that the Iowa Electronic Transmission of Funds Act may not be enforced against U.S. Bank and/or any entity to which U.S. Bank provides correspondent, data processing and electronic services as described in the opinion.

# Is Federal Preemption “dead”?

- No, but it is certainly narrower.
- The OCC’s stated preemption stance, or at least the procedures they used to adopt that position, could be challenged in court.

# Merger of OTS into OCC

- The demise of the OTS and growth of the OCC – all national banks and federal thrifts are now subject to Office of the Comptroller of the Currency. Merging two large banking agencies.
- The OCC assumed responsibility for the ongoing examination, supervision and regulation of federal savings associations as of July 21, 2011.
- OCC examiners have already begun to examine federal savings associations.

# Federal Payments

- US Treasury has announced checkless government payments by 2013
- In December 2010, US Treasury has released interim final regulations specifying that US government payments MAY be deposited onto prepaid cards, provided:
  - The prepaid account provides all Reg E “lite” protections
  - It is not attached to any line of credit program
  - The prepaid account is “in the name” of the government payment recipient
- Extended comment period; further clarification or guidance expected

*NOTE: reflects legislative and regulatory concerns about linking prepaid cards to small loan products.*

# Bank Regulators and 3<sup>rd</sup> Party Risk

- Bank regulatory focus on 3<sup>rd</sup> party risk management—long standing regulatory concern, but recently heightened attention
  - Each agency has multiple releases/guidance on 3<sup>rd</sup> party risk management (Ex: OCC Bulletin 2001-47; FFIEC Interagency Statement on Risk Management of Outsourced Technology Services; OTS Thrift Bulletin 82a; FDIC FIL-44-2008)
  - Types of risk: reputation, strategic, compliance, transactional, credit, regulatory
  - OCC and FDIC examiners particularly focused on this.

# Bank Regulators and 3<sup>rd</sup> Party Risk

- Bank issuer risk management requirements:
  - Risk assessment of the products/services to outsource
  - Due diligence in selection of 3<sup>rd</sup> party
  - Contract terms
  - Ongoing monitoring
  - Board reports and data
- The regulatory focus is no longer limited to programs involving subprime lending.

# Carol Osborne

## Consumer Protection since the CARD Act

# 2009: Prepaid Cards – Federal Consumer Protection Laws

## OLD NEWS:

- **Regulation E extended to Payroll Cards – July 1, 2007**
- **Credit Card Accountability Responsibility and Disclosure Act of 2009** (the “**CARD Act**”) Signed into law May 22, 2009; effective generally in August 2010
  - Gift Card Amendment covers both “open-loop” and “closed-loop” gift cards, codes and devices.
    - No Expiration Dates on Gift Cards prior to 5 years
    - No Monthly service fees on Gift Cards until after 12 months of inactivity
    - Disclosure requirements
    - Exemptions for reloadable non-gift cards; loyalty, award and promotional cards; admission tickets to events and venues; paper based products.
  - Continued compliance challenges for card issuers balancing Card Act against state law.
    - Only pre-empted less protective state laws

# 2011: Prepaid Cards – Federal Consumer Protection Laws

- **NEW NEWS:** Attempts to extend federal consumer protection laws to general purpose and other non-gift prepaid payments.
  - Menendez Legislation
  - Blumenthal Legislation
  - Federal Payments Regulations
- Arrival of a new Federal Regulator: CFPB
  - Consumer Groups Letter to the CFPB
  - Large Participant Notice

# Menendez Legislation: S. 2030

Introduced in 2010; reintroduced in December 2011

- Applies to “spending accounts” -- any pooled or non-pooled account opened by or for a consumer and containing consumer funds, which may be used by a consumer to make or receive payments
- Issuers must provide FDIC pass-through deposit insurance, which requires collection of consumer ID data
- Funds loaded must be deposited into an insured bank account “promptly” but not later than 1 business day after funds activated

# Menendez Legislation

- **The Bill would only permit specified fees:**
  - an activation, initiation, or enrollment fee;
  - a fee up to \$5 for the first replacement card in a 12-month period;
  - a fee for expedited replacement card delivery;
  - a reload fee if the issuer provides a method to add value without a fee;
  - a periodic fee, not more frequently than monthly but subject to activity rule;
  - a fee for a transfer from the spending card account to another account;
  - a fee for bill payment;
  - a fee for a consumer withdrawal from foreign ATMs or from an out-of-network ATM; and
  - a fee for a purchase or withdrawal in a foreign currency
- **All other spending-account fees would be prohibited**

# Menendez Legislation

- **Other terms addressed:**
  - Periodic statements
  - Regulation E
  - Disclosures
  - Exclusions for gift cards, health benefit cards
- **Not expected to pass in this election year.**
- **But nevertheless important:**
  - Supported by Consumer Groups
  - Is perceived as a “starting point” for regulation by the CFPB

# Blumenthal Legislation

- **Not yet introduced – draft circulating - Worse than Menendez**
- **Key provisions**
  - **Would eliminate most exclusions from the CARD Act (including exclusions for GPR card and Loyalty, Award, Promotional cards)**
  - **Would eliminate all service fees from the CARD Act**
  - **Would eliminate all expiration dates from the CARD Act**
  - **Would prohibit a company in bankruptcy from:**
    - **Selling/issuing Cards;**
    - **Refusing to honor Cards; and**
    - **Reselling/reissuing Cards (after 7 days have elapsed since the bankruptcy filing).**
- **Opens door to far more restrictive prepaid regulations**

# 2011: **State** Consumer Protection Laws

- State Consumer Protection Laws – More activity
  - Some states aligning their laws with the CARD Act
  - Push for more “cash back” laws –OR passes S 756 requiring that gift cards be redeemable for money/check only when the card’s value is less than \$5 and the card has been used for at least one purchase.
  - More limits on fees and expiration dates - CT passes H 6351 prohibiting expiration dates on the funds underlying general use prepaid cards, but permitting expiration dates on the cards themselves
  - High profile concerns about the Kardashian Kards
  - Florida AG investigates GPR cards for “abusive fees”

# Margo Strahlberg

## Abandoned Property Developments

# Background: Abandoned Property & Breakage

- All 50 states have abandoned property statutes, some of which require unused funds underlying “gift certificates,” “gift cards” or “prepaid cards” to be turned over to the state after a dormancy period (usually 3-5 years).
- However, many state statutes exempt such products, acknowledging that a card issuer’s ability to hold onto unused funds (aka “breakage”) is critical to prepaid card business models
- Two ways for card issuers to keep breakage
  - Closed Loop & Open Loop Cards
    - **Special purpose gift card company established in a state with favorable escheat laws**
    - Works for anonymous products only
  - Non-Anonymous Open Loop Cards
    - Debiting service fees

# Priority Rules

The U.S. Supreme Court established a priority scheme in order to determine which state law governs

- First Priority Rule: Unclaimed property goes to “*the State of the last known address of the owner*, as shown by the holder’s books and records.”
- Second Priority Rule: Where the holder has no record of an address at all or the last known address is in a state which does not provide for escheat of the unclaimed property, *the state of corporate domicile of the holder* has the right to the unclaimed property.
- Third Priority Rule/Transactional Rule: Where the holder has no record of an address at all or the last known address is in a state which does not provide for escheat of the unclaimed property, and the holder is a domiciliary of a state that does not provide for escheat of the unclaimed property, *the state where the transaction out of which the property arose* has the right to the unclaimed property.

# NJ's Abandoned Property Law

Law signed by the Governor on June 29, 2010; was to be effective July 1, 2010

- *Broad Definition*
  - Applies to all “stored value” – open and closed loop
- *Short Dormancy Period*
  - Establishes a dormancy period of 2 years
- *Data Collection Requirement*
  - Requires collection of purchaser ZIP code at POS
- *“Place of Purchase” Presumption*
  - If data not collected, presumption that purchaser is a NJ resident
- *Fees*
  - Prohibits ALL service fees triggered by inactivity
- *Retroactive Application*

**- LITIGATION SOON FOLLOWED -**

# U.S. District Court & Third Circuit Decisions

- *Dormancy Period – Upheld*
  - Short dormancy period not preempted by the CARD Act
- *Data Collection Requirement - Upheld*
  - The requirement to collect the purchaser’s name, address or ZIP code furthers the state’s goal of reuniting abandoned property with the purchaser
  - *Gives NJ a 1<sup>st</sup> priority claim to unredeemed funds*
- *Retroactive Application – Unenforceable*
  - *But only unenforceable with respect to non-cash accessible cards*
  - No arguments were raised on this issue with respect to cash accessible cards
- *“Place of Purchase” Presumption – Unenforceable*
  - Court ruled the “Place of Purchase” Presumption was preempted by Federal common law since it departs from the Supreme Court’s priority scheme
  - Court acknowledged *card issuer’s right to a “windfall”*

# Impact on Prepaid Card Programs

- **Fees Charged by Open Loop Issuers**
  - *Fees based on inactivity* (such as those permitted under the CARD Act) are *prohibited in NJ*
  - For now, service fees not based on inactivity appear to be valid and legal – for NON-gift cards, at least
- **Special Purpose Giftco – Ineffective with respect to NJ sales**
  - NJ has a 1<sup>st</sup> priority claim, defeating a special purpose giftco's 2<sup>nd</sup> priority claim
  - *Unused funds from anonymous gift cards sold in NJ to purchasers with a NJ ZIP codes are payable to NJ after 2 years of inactivity*
- **What's Next?**
  - Awaiting issuance of Guidance from NJ Treasurer
  - Possible Motion for a Rehearing or Motion to Appeal to the Supreme Court
  - Some card issuers are considering withdrawing their cards from NJ
  - *REAL CONCERN: Will other states follow?*

# Other Abandoned Property Developments in 2011

14 states proposed escheat legislation/regulations, but only 2 states enacted new laws relevant to prepaid cards:

- **Maine.** ME H 200 exempts gift obligations/stored value cards sold on or after December 31, 2011 by a single issuer who in the past calendar year sold no more than \$250,000 in face value of gift obligations/stored value cards. Does not include businesses under common ownership/control or franchises.
- **South Dakota.** SD S 76 excludes gift certificates and closed-loop prepaid cards that do not have expiration dates or dormancy, inactivity or service fees from SD's abandoned property law.

# Jennifer Crowder

## State Money Transmitter Licensing Developments

# State Regulations – Money Transmitter Licensing

- These are state laws that regulate non-bank entities that receive and hold consumer funds for purposes of transmission or to make payments.
- *These laws can apply to ANY payment product – from paper money orders to plastic prepaid cards – to mobile, virtual, online, and contactless payments.*
- Benefits: Power to issue payment products without a bank partner
- Problems: Burdensome, expensive and non-uniform laws – subject to audit in multiple states.
- Recent Developments
  - More states are aggressive about extending coverage
  - Increased penalties – especially for new applicants

# State Regulations – Money Transmitter Licensing

- Typical State Money Transmitter licensing requirements
  - Net worth requirements – from \$10,000 to (in 1 state) \$1 million
  - Bonding requirements
  - Criminal Background checks of principals, directors, officers
  - Quarterly reporting
  - AML compliance officer and programs required
  - Audited financials
  - Safety and soundness examination
- Often Banks and their agents are exempt from licensing
- Agents of licensed money transmitters are also exempt
- Often closed loop cards, or cards usable solely for goods/services, not for “cash,” are exempt.

# 2011: Recent Developments in State Money Transmitter Licensing laws

- 6 new state laws were enacted, adding technical changes, and extending the laws to new products.
- In addition, California and New York issued opinions relating to money transmitter licensing obligation
  - **California Opinion.** California issued an opinion confirming that third parties selling bank-issued, FDIC-insured GPR cards are exempt from licensing
  - **New York Opinion.** New York issued an interpretation reversing its longstanding position that licensing is not required for persons transmitting money in New York but without a physical presence in state
- Worrying trend: States increasingly aggressive in interpreting state laws to require licensing (where no license was required in the past – e.g., payment facilitators) and to impose penalties in larger amounts (\$50,000, \$75,000, or more) – even for companies who in good faith apply for a new license.

# Katherine Koops

## Structuring New Payment Deals

# Structural Issues – building or launching a prepaid or emerging payments business

- Three approaches:
  - Merger and Acquisition
  - Creating a Joint Venture
  - Contracting with a vendor or creating a partnership/strategic alliance
- Important differences for each approach
  - Timing and speed to market
  - Cost and risk
  - Control vs Reliance on others

# Structural Issues

- But for any approach – keeping on top of regulatory issues is paramount
  - **First Step: Money Transmitter licensing requirements**
    - One cannot simply purchase a licensed entity; each state has its own change of control requirements and some require the new owner to file a whole new application. Expect 6-12 months to obtain approvals.
    - Creating a new entity such as a Joint Venture may require new licensing applications as well. For new licenses, expect 12-24 months for completion of the process.
    - Many companies choose to partner with a bank or licensed money transmitter in order to reduce licensing obligations
      - For this to work, the company must be an “agent” or “authorized delegate” of its licensed or banking partner
      - The product must belong to the partner and funds must be held by the partner
      - Complex agreements are required to protect investments from changes in laws.

# Structural Issues

- **Second Step:**
  - Product design and pricing – will it comply with federal, state and local consumer protection laws.
- **Third Step:**
  - Addressing other regulatory issues:
    - AML compliance
    - Abandoned property
    - Federal and state consumer protection laws.
    - Bank regulatory approvals

Bottom line: These can be complex, multi-layered deals to structure.

# But the good news – it's doable and it's working

Some recent headlines from, Paybefore.com ---

- [Transact Network and Ixaris to Issue Virtual, Plastic Prepaid Visa Cards \(Dec. 23, 2011\)](#)
- [Fed Approves Green Dot's Bid for Bonneville \(Nov. 28, 2011\)](#)
- [Vantiv Files for IPO \(Nov. 11, 2011\)](#)
- [Bancorp, WISEKey Form JV to Serve U.S., EU and China \(Dec. 16, 2011\)](#)
- [FIS, Monitise Partner on Mobile Services Development \(Dec. 16, 2011\)](#)
- [Finish Line Teams with Transaction Wireless for E-Gift Cards \(Dec. 12, 2011\)](#)

# David Zetoony

## Privacy and Data Security Developments

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# Data Security Breaches and Class Actions

- 2011 an unprecedented year for data breaches:
  - 535 reported breaches (many unreported)
  - 6 of the most significant breaches in history
    - Sony Playstation Network, Epsilon, Nasdaq, Sutter Physicians, SAIC
    - <http://www.informationweek.com/news/security/attacks/232301079>
- Of greater concern – 2011's successful plaintiffs class actions:
  - *Claridge v. RockYou, Inc.* (April 11, 2011) (ND California)
  - *Anderson v. Hannaford Bros. Co.* (October 20, 2011) (First Circuit)
  - *Frawley v. Facebook* (December 19, 2011) (ND California)

# Data Security – Legal and Regulatory Issues

- Nearly all states have passed data breach laws
- Federal laws GLBA impact on Financial Institutions
- Every year, new efforts to establish federal law over data breaches – none yet successful
- However the FTC recently suggested that businesses that provide B2B services are responsible for ensuring that their clients have good data security, and that their clients are not hacked ( ie, liability for downstream breaches).

# Data Security and Privacy

- Expect MORE data breaches and more class actions
- Companies and financial institutions that suffer breaches will be subject to scrutiny regarding each step taken.
- The CFPB and the FTC both view their roles as protecting consumers when this occurs.

# Jennifer Crowder

## Mobile Payments and Electronic Wallets

# Federal Communications Commission (FCC) and Mobile Payments

- At Payments 2011, FCC and other Federal Regulators: “Mobile payments regulations will not be introduced any time soon.”
- Sticking point: large number of regulatory agencies and industry players
- Multiple parties, such as financial regulators, FCC, FTC and Department of Commerce, mobile industry stakeholders, need to agree
- Many believe CFPB will play major role

# FCC and Mobile Payments

- AT&T Mobility, Verizon and T-Mobile -- licensed by the FCC to use radio spectrum in the provision of wireless communications services -- have formed a joint venture, ISIS, to develop the mobile payments market.
- These are FCC licensed commercial mobile carriers and are subject to various provisions of the Communications Act, 47 USC 151, et.seq. all of which are listed in section 20.15(a) of the FCC's rules, 47 CFR 20.15(a).
- July 2011 – ISIS announces relationship with all 4 payment networks: Visa, MasterCard, American Express, Discover
- Salt Lake City and Austin TX announced as first test markets

# FCC and Mobile Payments

- The applicable provisions of the FCC regs impose common carrier obligations on FCC licensees and preclude unjust, unreasonable and unduly discriminatory practices by carriers.
- The FCC has authority to act on complaints that the carriers have violated their statutory obligations.
- The carriers would likely prefer to have an FCC policy for mobile payments - more certainty as to what practices they can or cannot engage in consistent with their responsibilities as common carriers subject to the Communications Act.
- Currently no public FCC initiative at present to develop such a policy.

# Mobile Payment – Potential Regulation

- August 2009 Notice of Inquiry, FCC sought comments on Innovative uses of Wireless Technology
  - CTIA urges FCC to adopt “best practices” and take leadership role – but *not* impose prescriptive restrictions
- 2011: Current approach to mobile payment regulation:
  - Most agree that being “mobile” is merely a “form factor” – the underlying payment systems and laws are the same, whether the mobile payment product is based on credit, debit or prepaid.
  - Some mobile payment companies have obtained money transmitter licenses
  - In December 2011, Consumers Union and other consumer groups wrote to wireless carriers urging them to provide consumers the same protections when purchasing items using a mobile phone or tablet that they have when using a credit or debit card.
- CFPB is expected to regulate mobile payments in the future.

# Electronic Wallets – What are they?

- A form of mobile payments that allows a smart phone or tablet to hold multiple payment products - concept is to “leave cards at home”
- Wireless smart phones or tablets have an application that can hold each consumer’s payment products
- Chip or wireless feature is used to communicate with the retailer or store as to which payment product is used.
- Often the application designates which payment method will be used first, second, third, etc.
- **Each payment product is separately issued and is still subject to existing laws and regulations.**

[PayPal: Predicts 2016 Tipping Point for Mobile Commerce in U.K. \(Paybefore.com - Nov. 28, 2011\)](#)

[Some predict Tipping Point in the US will be much sooner – 2012 or 2013  
At least for certain applications – Starbucks, Mass Transit, etc](#)

# Barry Hester

## Lending Products, Remote Deposit Capture and Payroll Cards

# Federal Regulations – Regulation Z

- Difficulty in adding credit lines to prepaid cards.
- Prepaid cards as credit cards?
  - Final Rule amending Reg Z effective October 1, 2011
  - If card is associated with an account number that accesses a line of credit to directly purchase goods or services, it is a “credit card”
  - If line of credit only moves funds from the line of credit to the prepaid card, it is not a “credit card”
  - Must have a clear two-step process to avoid characterization as a credit card

# Recent trend – regulatory disapproval of credit products linked to prepaid

- MetaBank and i-Advance
- Treasury regulations on Federal payments – disallowing loads onto card with credit programs triggered by the federal payment
- Menendez legislation restricting credit lines or credit products

*Don't forget the vast number of state lending laws impacting non-banks...*

# One hopeful sign of regulatory flexibility: OCC Guidance

- June 2011 – the OCC issued proposed guidance on safe and sound banking practices for **deposit-related consumer credit products**, such as automated overdraft protection and direct deposit advance programs
- Outlines risk considerations, not prohibitions on pricing, usage or other terms
- Product disclosure and enrollment; legal compliance; program availability and prudent eligibility standards; prudent limitations on product costs and usage; ongoing monitoring and risk assessment; and management oversight
- Provided these considerations were addressed the OCC's proposal did NOT rule out credit products linked to debit or prepaid cards

# Remote and Mobile Deposit Capture

- One of the more significant trends for prepaid and emerging payments.
- Allows unbanked consumers to load checks onto their prepaid payment product by scanning at a kiosk or retail outlet, or by taking a cell phone picture and texting it to the depository institution – more convenient and avoids the cost of check-cashers.
- RDC/MDC relies on existing check imaging laws put in place by Check 21.
- Should be non-controversial, but some have raised “deposit-taking” issues, or question whether RDC/MDC falls under check-cashing licensing laws.

# Payroll Cards

- Payroll Cards coming under increasing regulatory scrutiny and legislative focus
  - Federal legislation: Proposed Electronic Paycard Protection Act of 2011 (US HR 2125) amends the Fair Labor Standards Act of 1938, modeled after CA A 51.
  - California (CA A 51) – based on a consumer group model act that so severely limited fees and imposed so any obligations that employers and even labor unions opposed it. It ultimately failed.
- Bryan Cave Wage and Payroll Instrument Survey

# Carol Osborne

## Social Couponing

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# What are “social couponing” programs?

- Online marketplace for buying and receiving coupons or vouchers for discounted price on wide variety of products and services combined with social networking
- Surge in number of companies launching since Groupon in 2008; more local focus
- How it works
- Key features
  - Daily deal
  - Tipping point
  - Free for 3 friends
- Who is at risk?

# Problems with Litigation and Class actions

- The combination of an expiration date with the payment by a consumer of even a discounted fee for the coupon triggers coverage under many state laws and potentially the CARD Act .
- Groupon and similar programs CAN be implemented with low risk, if done properly.
- Generally successful programs bifurcate the paid certificate (which never expires) from the additional “bonus” which is for a limited time only>
  - For example, pay \$25 for a coupon to a restaurant. That coupon will be redeemed for \$50 but only for two weeks. After that, the coupon can be redeemed at any time for the \$25 face amount

# Lessons learned

- New and successful payment products – including reward and promotional products need to be considered under the terms of existing laws.
- Both federal and state laws are written very broadly, so that virtually any payment product – especially one in which the consumer pays in advance – will be covered.

# Pre-Submitted Questions and Answers

**9 more questions from our participants...**

# Parting thoughts on 2011

- Increased competition and conflict - - -
  - The Debit vs. Prepaid Issuers (AML; Loans; Durbin)
  - The Large bank vs. Small bank issues
  - Retailers vs Payment companies
- AML and mixed messages from Law Enforcement:
  - Executive Director for ICE-Homeland Security Investigations James Dinkins indicated that ICE has investigated more than 100 cases involving prepaid cards **but he has not seen the “explosion” in cross-border movement of illicit funds using prepaid cards that he’d expected.**
  - Use of Payroll Card programs linked to significant high-profile criminal and terrorist activity and more proposed legislation/regulation.
- Pricing and fee controls vs. Disclosures and fair advertising
- Consumer and Media Communications: Suze Orman cards vs. the “Kardashian Kard” and other PR disasters. And now, CNN..

# Looking forward to 2012

- **Everyone is looking for an exemption**
  - **DURBIN, FinCEN, State Money Transmitter Licensing laws, State abandoned property laws**
- **The biggest uncertainty and most likely serious regulatory change will come from the CFPB**
- **Prepaid and Emerging Payments will come under heavy pressure – but to survive, must keep focus on consumers.**
- **The better these products serve consumers, the less likely regulatory and legislative actions will deter them.**

# Bryan Cave's Prepaid and Emerging Payments Team

For legal counsel and advice in:

Prepaid and Stored Value | Mobile and Contactless Payments | Bank Regulatory Compliance | Money Services Business (MSB) Compliance  
Electronic Wallets and P2P Payments | Anti-Money Laundering Compliance | Bill Payment, Overdrafts and Lines of Credit | Retail Gift Cards | Abandoned Property  
Money Transmitter Licensing | Privacy and Data Security | Patents and Intellectual Property | Litigation Strategy and Defense



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*A Broader Perspective<sup>SM</sup>*